EXHIBIT 39

Direct Placement Of Corporate Securities

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CHAPTER I

A Preliminary Appraisal

AMONG the most significant of the fundamental changes that have taken place in corporate financing since the early 1930's has been the increasing reliance by American industry on direct financing. The traditional approach to the flotation of security issues — distribution of security issues through investment bankers to large numbers of investors in the public capital markets — is yielding in importance to the private sale of entire issues directly to one or a few institutional investors. The tremendous growth in institutional savings over the past 30 years, especially in the form of life insurance reserves, has been a necessary condition to this trend in business finance.

In the four postwar years, 1946–1949, direct placements of $9.9 billion accounted for 36.7% of total corporate security flotations amounting to an unprecedented $26.8 billion. In 1948 alone, direct placements in the amount of $3.3 billion represented 45% of corporate flotations in that year (Exhibit 1).

THE MATTER OF DEFINITION

Direct or private placement can be appropriately regarded as a *method of negotiation and sale.* There are no specific characteristics by which a directly placed security issue may be distinguished *in form or in content* from securities traded in the public markets.

Direct placement refers therefore to the procedure in which the corporate issuer and the institutional investor deal directly with each other, with or without the aid of an intermediary, in establishing the terms of a security issue, and in which title to the security, or securities, is taken directly by the final holder. Securities negotiated and sold by this method are *directly* placed in the sense that they are not first sold to

intermediate owners (e.g., investment bankers) who have purchased with the intent of reselling. These securities are alternatively referred to as *private* placements because they fall under the provision of the Securities Act of 1933 which exempts from registration with the Securities and Exchange Commission "transactions by an issuer not involving any *public* offering." (Italics added.)

For purposes of this study, it is useful to qualify the above definition by excluding from its meaning "term lending by commercial banks." The close similarity between directly placed debt issues and term loans has frequently been noted. Covenants that tend to be characteristic of one are often found in the other, and both involve direct negotiation between the borrower and the lender. Term loans, however, are typically made for smaller amounts and for shorter maturities than are direct placements. These distinctions are significant, and therefore the inclusion of term loans within the meaning of direct placements would be inappropriate.

It may be noted, as well, that the definition is not intended to include the purchase, for investment and not for resale, of securities which were floated under open competitive bidding procedures. Even though in such an instance title to the security is taken directly by the final holder, these issues have, of course, been offered publicly, and their terms were established in final form prior to being offered. Thus no opportunity was provided for direct negotiation between the issuer and the lender.

Direct Placement Statistically Described

In the initial examination which follows,[1] direct placement financing will be broadly described in an effort to answer such questions as these: What is the nature of the market for

[1] *Statistical Note* The statistical data used in the analysis of the direct placements acquired by the 18 largest life insurance companies (Exhibits 2–6 and 8) have been developed from the reports which life companies are required to make annually to the insurance departments of those states in which the companies write policies In Schedule D, Part III, of the report form are listed bonds and stocks acquired during the calendar year. For each security added to a company's portfolio during the year, the company must report in Part III the type of security, the date of purchase, the date of

direct placements? i.e., who invests in these securities? What sizes and kinds of corporations are financed through private placement? How large are these issues? Of what maturities? In what forms are direct placements typically issued: bonds, preferred stocks, common stocks, etc.? A description of direct placement financing framed in these terms serves to mark out the areas requiring detailed examination in this study.

The Institutional Investor

The market for direct placements consists almost exclusively of institutional investors; among this group life insurance companies are by far the predominant purchasers. In 1947, 93% of the total volume of privately negotiated securities was taken by life companies and less than 3% went to banks.[2] Securities and Exchange Commission data indicate further that life company predominance in the direct placement field had been well established prior to World War II.

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maturity, the name of the issuing corporation, the name of the vendor, the total cost of the issue to the insurance company, and its principal amount. Private placements can be distinguished from public offerings in these records by comparing the name of the issuing corporation with the name of the vendor. Where the two are identical, or where the word "direct" or "private" has been used in the "Vendor" column, the issue was placed directly

This method of identifying direct placements is sufficiently accurate to serve the purposes for which it has been used here It does not enable us, however, to differentiate issues obtained by life insurance companies through competitive bidding from those acquired by direct negotiation. The former are known to be rare, however, and the resultant inaccuracy introduced into the data on direct placements is regarded as negligible.

The dollar value figures used for debt issues represent "principal amount" and not "cost to company." "Cost to company" was the value figure used for stock issues. In developing data regarding the number of direct placements, issues in which more than one of the 18 life companies participated were nevertheless regarded as single issues.

Figures representing total acquisitions of both direct placements and all corporate securities were adjusted to leave out issues having maturities of less than one year. These issues, consisting in large part of 30- to 90-day discount notes, were excluded to avoid any distortion in the annual figures that might otherwise result.

[2] Financial Analysis Section, Securities and Exchange Commission, July 28, 1949. See Hearings before the Subcommittee on Study of Monopoly Power of the House Committee on the Judiciary, *Study of Monopoly Power,* Serial No 14, Part 1, 81st Congress, 1st Session (Washington, Government Printing Office, 1949), p. 476.

From the investor's point of view, the area of study may be even more sharply defined by focusing on the largest life companies. Of over 580 life insurance companies in the United States, the 18 largest account for approximately 80% of the total admitted assets of all life companies taken in the aggregate. These investors tend to have a much greater percentage of their portfolios in direct placements than the smaller insurance companies have. A conservative estimate would be that the direct placements acquired by the 18 largest companies represent almost 90% by dollar amount of all directly negotiated securities. Much useful information can

EXHIBIT 2. DIRECT PLACEMENTS COMPARED TO ALL CORPORATE SECURITIES ACQUIRED BY 18 LARGE LIFE INSURANCE COMPANIES, 1946–1949
(Dollar amounts in millions)

	Bonds			Stocks		
Year	*Rails*	*Utilities*	*Industrial and Miscellaneous*	*Preferred*	*Common*	*Total*
			Direct Placements			
1946	$2.1	$271.3	$1,465 5	$13.9	$0 3	$1,753.1
1947		466.7	1,646.7	62 4	0 3	2,176.1
1948	38.0	536.2	2,220.9	52.5		2,847.6
1949	21 0	524.0	1,604.1	30.1	0 2	2,179.4
Total	$61.1	$1,798 2	$6,937 2	$158.9	$0.8	$8,956.2
			Total Acquisitions			
1946	$324 6	$859.6	$1,778.1	$184.1	$42 6	$3,189.0
1947	266 9	1,593 5	1,903.5	183.6	14 9	3,962 4
1948	196 0	1,575.0	2,310 0	98.7	14 9	4,194 6
1949	99 0	1,090.0	1,920 9	138 2	34.8	3,282 9
Total	$886 5	$5,118.1	$7,912.5	$604.6	$107.2	$14,628 9
			Direct Placements as a Percentage of Total Acquisitions			
1946	0 6%	31 6%	82 4%	7 5%	0.8%	55 0%
1947	0 0	29 0	86.5	36 6	2.5	54 9
1948	19 4	34 0	96.1	53.2	0 0	67.9
1949	21 2	48.1	83 5	21 8	0 4	66 4
1946–1949	6 9%	35.0%	87.7%	27 1%	0.8%	61.2%

SOURCE: Computed from annual reports submitted by the 18 largest life insurance companies to the Division of Insurance of the Massachusetts Department of Banking and Insurance. See Statistical Note, p. 4

be developed through a concentration of focus on the private placements acquired by these 18 companies without sacrificing significantly on over-all coverage.

To what extent are the corporate securities held by these large companies acquired through direct negotiation? In the four-year period, 1946–1949, this group of companies invested $8.95 billion, 61% of the total amount they invested in corporate securities, in directly negotiated issues (Exhibit 2). It is striking to note that 87.7% by dollar amount of the industrial and miscellaneous bonds acquired were direct placements. Only 35% of their acquisitions of public utility bonds and 6.9% of railroad bonds were purchased directly, while 27.1% of preferred stock and 0.8% of common stock acquisitions were privately negotiated. The over-all ratio of direct placements to total acquisitions of corporate securities, 61%, was heavily weighted by the large volume of industrial and miscellaneous bonds.

Substantial differences are evident among the 18 companies in the extent to which their securities acquisitions are concentrated in direct placements. The principal amount of private placements as a percentage of the total dollar amount of corporate securities purchased by each of these companies varied over the period studied from 8% to 83%. Only as a rough generalization is it possible to say that the larger the company the greater the tendency to concentrate its acquisitions in direct placements (Exhibit 3).

Although the great majority of direct placements were negotiated and purchased by life companies acting singly, two or more of the 18 companies frequently participated in the purchase of large direct placements. In the 1946–1949 period, each of 344 directly negotiated issues (45% by total dollar amount) was shared by two or more of these institutional investors. It has been estimated that 62 direct placements (out of 2,002) each involved from 5 to 14 participating purchasers — all among the 18 large life companies. It was impossible to tell, of course, from the data that were examined how many other institutional investors, in addition to the 18 companies, shared in these issues.

EXHIBIT 3. DIRECT PLACEMENTS COMPARED TO ALL CORPORATE SECURITIES ACQUIRED BY EACH OF 18 LARGE LIFE INSURANCE COMPANIES, 1946–1949

(Dollar amounts in millions)

Life Insurance Companies (Listed in Order of Size)	*Direct Placements*	*Total Acquisitions*	*Direct Placements as a Percentage of Total Acquisitions*
Metropolitan Life Insurance Company	$2,353 4	$3,154 5	74.6%
The Prudential Insurance Company of America	1,408.1	1,681 6	83 7
The Equitable Life Assurance Society of the United States	1,892.8	2,515 7	75 2
New York Life Insurance Company	616 5	1,505 4	41 0
John Hancock Mutual Life Insurance Company	472.1	942 1	50 1
Northwestern Mutual Life Insurance Company	377 8	759 3	50 0
The Mutual Life Insurance Company of New York	509 5	874 7	58 3
The Travelers Insurance Company	85 4	258.0	33 1
Aetna Life Insurance Company	154.6	460 3	33 6
Massachusetts Mutual Life Insurance Company	379 5	570 2	66 6
The Penn Mutual Life Insurance Company	258 6	445 4	58.1
Mutual Benefit Life Insurance Company	122 3	261.3	46 8
New England Mutual Life Insurance Company	139 7	433 1	32 3
Connecticut Mutual Life Insurance Company	57.9	205.9	28 1
Connecticut General Life Insurance Company	18 2	169 7	10 7
Union Central Life Insurance Company	11 0	136.4	8.0
Provident Mutual Life Insurance Company	91.3	190 3	48 0
Phoenix Mutual Life Insurance Company	7 5	65 0	11 6
Total	$8,956 2	$14,628 9	61 2%

SOURCE: Computed from annual reports submitted by the 18 largest life insurance companies to the Division of Insurance of the Massachusetts Department of Banking and Insurance See Statistical Note, p 4

Form, Size, and Maturity of Direct Placements

The direct placements acquired by the 18 large life companies consist overwhelmingly of debt issues. Preferred and common stocks together account for only 1.8% by dollar amount of all direct placements (Exhibit 4).

Approximately half of the debt issues by both dollar amount and number were negotiated as notes. Even though the note form has been customarily associated with short-term obligations, its use in direct placement seems to be without reference to the short-term or long-term nature of the agreement. Almost three-quarters, by dollar amount, of all note issues provided for final maturities of 15 years or longer.

EXHIBIT 4 DIRECT PLACEMENTS ACQUIRED BY 18 LARGE LIFE INSURANCE COMPANIES, 1946–1949, CLASSIFIED BY FORM OF SECURITY

Form of Security	*Amount*	*Percentage of Total Amount*	*Number*	*Percentage of Total Number*
Debentures	$1,891,864,772	21.1%	260	13 0%
Mortgage Bonds	2,406,589,781	26 9	628	31 4
Notes	4,421,502,445	49 4	999	49 9
Preferred Stocks	158,858,344	1 8	80	4 0
Common Stocks	828,125		8	0.4
Miscellaneous *	76,545,635	0 8	27	1 3
Total	$8,956,189,102	100 0%	2,002	100 0%

*Convertible debentures, equipment trust certificates, etc

SOURCE: Computed from annual reports submitted by the 18 largest life insurance companies to the Division of Insurance of the Massachusetts Department of Banking and Insurance. See Statistical Note, p 4.

Direct placements are typically made for relatively large amounts. Thus 60% of the total number and 96% of the total amount of all issues negotiated directly by the 18 large life companies between 1946 and 1949 were for amounts over $1 million (Exhibit 5). Eight of these issues, amounting in the aggregate to $1,067 million, were made for principal amounts of $100 million and over. The largest single direct placement financing of record was the issue of 4% 20-year bonds of the Shell Caribbean Petroleum Company. Eight of

EXHIBIT 5. DIRECT PLACEMENTS ACQUIRED BY 18 LARGE LIFE INSURANCE COMPANIES, 1946–1949, CLASSIFIED BY THE PRINCIPAL AMOUNT OF ISSUE

Principal Amount * *(in thousands)*	*Amount*	*Percentage of Total Amount*	*Number*	*Percentage of Total Number*
Under $50	$ 306,128	0.0%	11	0 6%
$ 50–$ 100	2,103,962	0.0	31	1.6
100– 200	11,625,759	0.1	85	4.2
200– 500	90,731,319	1.0	289	14.4
500– 1,000	243,604,445	2.7	375	18 7
1,000– 2,000	585,764,250	6.5	452	22.6
2,000– 5,000	1,114,438,072	12.4	382	19.1
5,000– 10,000	1,131,414,420	12.6	177	8.8
10,000– 20,000	1,283,879,000	14.3	98	4.9
20,000– 50,000	2,119,591,747	23.9	73	3.7
50,000– 100,000	1,305,205,000	14.6	21	1.0
100,000 and over	1,067,525,000	11.9	8	0.4
Total	$8,956,189,102	100.0%	2,002	100.0%

* Stock issues are included in these data on an actual cost basis.

SOURCE: Computed from annual reports submitted by the 18 largest life insurance companies to the Division of Insurance of the Massachusetts Department of Banking and Insurance. See Statistical Note, p. 4.

the 18 largest life insurance companies purchased $235 million of these securities, with one company, Metropolitan Life Insurance Company, contributing $100 million of this amount.[3] This single commitment on the part of Metropolitan Life, and a loan of an equal amount made by The Equitable Life Assurance Society to the Gulf Oil Corporation, stand as the largest amounts invested by single life companies in one corporate issue.

Issues under $50,000 in size aggregated only about ½ of 1% of the total number of directly placed issues and accounted for $306,000 out of total direct placements valued at $8.95 billion. Of course, if the data from which this information is derived were to cover all life insurance companies, the *number* of issues under $50,000 would represent a more significant fraction of the total number.

The directly negotiated debt securities acquired by these

[3] The Sun Life Assurance Company of Canada and the Carnegie Corporation also participated to bring the total amount of the issue to $250 million.

large life companies are predominantly long-term. Over 96% by dollar amount of the issues and over 93% by number were negotiated with final maturities of eight years or longer. Eighty-five per cent by principal amount of these securities had final maturities of 13 to 40 years (Exhibit 6).

It should be noted here that the largest life companies frequently purchase short-term paper, typically in the form of 30- to 90-day discount notes, directly from corporate borrowers. These securities have been used as a temporary outlet for idle cash, and, because of the short maturities involved, this debt may be "turned over" several times in a year. These discount notes are predominantly the obligations of short-term credit companies. Because these amounts would distort the measure of total corporate security acquisitions on an annual basis, they have been omitted from the data given in Exhibits 2–6 and 8.

The Corporate Issuer in Direct Placement

Direct financing has been undertaken primarily by medium- and large-size firms. Data developed on the directly placed debt issues held in the portfolios of 17 large life companies in

Exhibit 6. Direct Placements Acquired by 18 Large Life Insurance Companies, 1946–1949, Classified by Number of Years to Final Maturity

Number of Years	*Amount*	*Percentage of Total Amount*	*Number*	*Percentage of Total Number*
1– 2	$ 4,650,000	0.1%	3	0 2%
3– 7	294,883,132	3 3	126	6.6
8–12	1,000,095,984	11.4	457	23 9
13–17	2,366,171,681	26 9	579	30 2
18–22	3,196,785,658	36.3	338	17.6
23–27	1,047,199,000	11.9	202	10.5
28–32	722,540,106	8.2	195	10.2
33–37	124,715,072	1.4	9	0.5
38–40	39,462,000	0.5	5	0.3
Total	$8,796,502,633	100.0%	1,914	100 0%

Source· Computed from annual reports submitted by the 18 largest life insurance companies to the Division of Insurance of the Massachusetts Department of Banking and Insurance. See Statistical Note, p. 4.

1948 indicate that only 0.32% by dollar amount of these securities were issued by corporations having less than $1 million in total assets. Over 88% had been issued by corporations each having more than $10 million in total assets (Exhibit 7).

Life company direct placement financing has been broadly spread over all segments of industry. As would be expected, however, areas which were expanding most rapidly in the

EXHIBIT 7. DIRECTLY PLACED CORPORATE BOND ISSUES HELD IN THE PORTFOLIOS OF 17 LARGE LIFE INSURANCE COMPANIES,* CLASSIFIED BY ASSET SIZE OF ISSUING CORPORATION, 1948

(Dollar amounts in thousands)

Size of Obligor †	*Amount of Issues* ‡	*Percentage of Total*
Under $500	$ 4,669	0 07%
$500 to $1,000	17,511	25
$1,000 to $2,000	76,690	1 09
$2,000 to $5,000	307,420	4 37
$5,000 to $10,000	387,205	5 50
$10,000 to $20,000	620,700	8 81
$20,000 to $50,000	1,073,790	15 25
$50,000 to $100,000	895,785	12 72
$100,000 to $200,000	1,050,046	14 91
$200,000 to $500,000	1,132,310	16 08
$500,000 to $1,000,000	1,001,230	14 22
$1,000,000 and over	438,027	6 22
Information lacking	36,077	.51
Total	$7,041,459	100 00

* The 18 largest life companies with the exception of The Equitable Life Assurance Society.

† After financing.

‡ Dollar figures are based on "cost of issue" and not on "principal amount."

NOTE: Components may not add to totals because of rounding.

SOURCE: Investment Research Department of the Life Insurance Association of America.

postwar years attracted the greatest investment of life company funds. Out of $8.95 billion of total private financing by the 18 large life insurance companies in the 1946–1949 period, $4.34 billion, over 48% of the total, went to finance five major industries as follows: chemicals and allied prod-

ucts, $601 million; oil production, transportation, and refining, $1,565 million; natural gas production and gas pipe lines, $673 million; electric light and power, $629 million; short-term credit agencies (except banks), $872 million (Exhibit 8).

Plan of Approach

In succeeding chapters direct placement will be examined both from the viewpoint of the institutional investor and from the viewpoint of the corporate issuer. The life insurance companies' approach to direct negotiation is conditioned to a large extent by the necessity of finding legally qualified investment outlets for their ever-increasing funds. The chapter which follows finds, in an examination of the over-all problems associated with the investment of life company funds, much of the explanation of the degree to which, and the characteristic ways in which, direct placement has developed.

The discussion examines, in Chapters III–V, the reasoning behind the evident preference for direct financing on the part of many business managements, and determines the conditions under which companies prefer the alternative of public flotation of security issues.

In somewhat the same way, the institutional investor faces a choice between the public and the private markets. Chapter VI deals with the considerations which bear on his choice between purchasing publicly offered securities and negotiating directly with corporate issuers.

Chapter VII provides an appraisal of the bargaining nature of private negotiations and the terms which typically result. There follows in a succeeding chapter an examination of the long-term relationship between the corporate issuer and the institutional investor that may evolve through the medium of a directly negotiated instrument. Unfortunately, conclusions in this area are difficult to arrive at because the relationship in question cannot be viewed against a background of long experience.

A great deal of the information relative to the selection of

EXHIBIT 8. DIRECT PLACEMENTS ACQUIRED BY 18 LARGE LIFE INSURANCE COMPANIES, 1946–1949, CLASSIFIED BY TYPE OF BUSINESS FINANCED

Type of Business	*Amount*
Mining and Quarrying	
Mining: Metal, Anthracite, and Bituminous Coal	$ 24,243,750
Crude Petroleum Production	204,876,769
Natural Gas Production	36,049,205
Total Mining and Quarrying	(265,169,724)
Manufacturing	
Food and Kindred Products	376,195,000
Beverages	153,838,219
Tobacco Manufactures	324,000,000
Cotton Manufactures	33,510,979
Textile-Mill Products, except Cotton	132,780,000
Apparel and Products Made from Fabrics	27,925,000
Leather and Products	9,417,000
Rubber Products	116,795,000
Lumber and Timber Basic Products	13,750,000
Furniture and Finished Lumber Products	16,672,607
Paper and Allied Products	225,334,000
Printing and Publishing Industries	74,015,990
Chemicals and Allied Products	600,980,277
Petroleum Products	868,918,985
Stone, Clay, and Glass Products	54,405,000
Iron, Steel, and Products	309,935,000
Nonferrous Metals and Their Products	136,734,000
Electrical Machinery and Equipment	317,901,488
Machinery, except Transportation Equipment and Electrical	368,782,083
Automobiles and Equipment, except Electrical	223,010,000
Transportation Equipment, except Automobiles	90,562,000
Other	750,000
Total Manufacturing	(4,476,212,628)
Public Utilities	
Transportation	
Railroads	54,011,898
Railways, Street, Suburban and Interurban	26,818,920
Air Transportation	44,000,000
Pipe Line Transportation, Gas	636,535,993
Pipe Line Transportation, Oil	222,260,000
Oil Tankers	269,174,472
Other	10,715,000
Total Transportation	(1,263,516,283)

EXHIBIT 8 (*Continued*)

Type of Business	*Amount*
Telephone and Telegraph Communication	153,773,700
Electric Light and Power	629,184,950
Gas, Distribution and Manufacture	308,086,000
Water	88,211,964
Other	4,615,000
Total Public Utilities	(2,447,387,897)
Trade, Retail and Wholesale	377,314,000
Service (Hotels, Repair Services, Motion Pictures, Other Amusements, etc)	97,630,646
Finance, Insurance, Real Estate, and Lessors of Real Property	
Banks and Trust Companies	5,134,200
Long-Term Credit Agencies, Mortgage Companies, except Banks	612,379
Short-Term Credit Agencies, except Banks	872,207,000
Insurance Carriers, Agents, etc.	2,706,681
Real Estate, including Lessors of Buildings	188,769,336
Total Finance, Insurance, and Real Estate	(1,069,429,596)
Construction	8,500,000
Total Classifiable Firms	$8,741,644,491
Unclassifiable Firms	214,544,611
Total	$8,956,189,102

SOURCE. Computed from annual reports submitted by the 18 largest life insurance companies to the Division of Insurance of the Massachusetts Department of Banking and Insurance. See Statistical Note, p. 4.

direct placement as a method of financing for the borrower and as an investment outlet for the lender has been developed from actual case studies. Four of these studies are included in Part II. The cases deal with situations in which the choice of a method of financing was a primary concern and in which the negotiations between a corporate issuer and institutional investors can be closely examined. The information which made the development of the cases possible was supplied by those executives of life insurance companies and of corporations who made the decisions to undertake private placement financing and who were charged with carrying out the actual negotiations.